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In the Supreme Court of the United States

OCTOBER TERM, 1942

No. —

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE, PETITIONER

v.

S. B. HEININGER

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of Guy T. Helvering, Commissioner of Internal Revenue, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Seventh Circuit entered in the above entitled cause on February 15, 1943, and reversing the decision of the Board of Tax Appeals.

OPINIONS BELOW

The opinion of the Board of Tax Appeals (R. 25-34) is reported in 47 B. T. A. 95. The opinion of the circuit court of appeals (R. 46-50) is reported in 133 F. (2d) 567.

JURISDICTION

The judgment of the circuit court of appeals was entered on February 15, 1943. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the taxpayer, who was engaged in the business of making and supplying artificial dentures by mail order, can deduct as ordinary and necessary business expenses under Section 23 (a) of the Revenue Acts of 1936 and 1938 the sums spent by him in unsuccessfully resisting the issuance and enforcement of a fraud order by the Postmaster General relating to such business.

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 8-10.

STATEMENT

The pertinent facts, as stipulated by the parties and as found by the Board, are as follows (R. 25-29):

The taxpayer was a licensed dentist in Illinois during the years 1926 to 1939. His principal work since 1932 was the making of artificial dentures for customers who did not personally visit his office. Before such dentures were made for a customer, the taxpayer required from and there

was forwarded to him from such customer a payment of \$2 generally designated as a "deposit". The dentures, when completed, were mailed or shipped, C. O. D., for the amount of the charges less the \$2 "deposit". (R. 25.) The gross receipts from this business, in 1937, were \$287,582.82, and for 1938 they amounted to \$150,168.27 (R. 29).

On September 22, 1937, a citation was issued by the Solicitor of the Post Office Department, charging that the taxpayer was engaged in conducting a scheme for obtaining funds through the mails by means of false and fraudulent practices, in violation of Section 3929 of the Revised Statutes (Appendix, *infra*). Shortly thereafter the taxpayer appeared before the Post Office Department, answered these charges, and employed attorneys to render legal services in resisting the issuance of a statutory "Fraud Order". (R. 27.)

On February 19, 1938, and after a hearing under the above-mentioned citation, the Postmaster General issued a "Fraud Order;" forbidding the Postmaster, at Chicago, Illinois, to pay any money orders drawn to the order of the taxpayer, and instructing the Postmaster to return all mail addressed to the taxpayer, to the senders, marked "Fraudulent". Thereafter, on February 25, 1938, the taxpayer filed suit in the District Court for the District of Columbia against James A. Farley, Postmaster General, and on that date the court

entered an order directing the latter to hold all mail addressed to the taxpayer until the further order of the court. (R. 27.)

On June 6, 1938, the district court granted the taxpayer a permanent injunction, restraining the Postmaster General from enforcing the "Fraud Order" or otherwise proceeding in accordance with its terms. On appeal, the order of the district court was reversed and the case was remanded with instructions to dissolve the injunction and to dismiss the bill of complaint. The taxpayer's application for a writ of certiorari was denied in the October Term, 1939.¹ The taxpayer paid attorneys' fees and other legal expenses in connection with the above-mentioned proceedings amounting to \$7,069.99 in 1937, and to \$29,530.56 in 1938. (R. 27-28.)

The Commissioner refused to allow the taxpayer to take deductions for these sums, and the Board of Tax Appeals approved the Commissioner's determination on the ground that such expenditures did not constitute ordinary and necessary expenses of the taxpayer's business but were incurred in connection with illegal practice (R. 27, 31-34). The circuit court of appeals reversed the decision of the Board of Tax Appeals (R. 46-50).

¹ That case is reported as *Farley v. Heininger*, 105 F. (2d) 79 (App. D. C.), certiorari denied, 308 U. S. 587.

SPECIFICATION OF ERRORS TO BE URGED

The circuit court of appeals erred:

1. In holding that expenses incurred in unsuccessfully resisting the issuance of a fraud order by the Postmaster General should be treated as ordinary and necessary business expenses and may be deducted from gross income.
2. In reversing the decision of the Board of Tax Appeals.

REASONS FOR GRANTING THE WRIT

The decision of the Seventh Circuit in this case is in conflict with the decision of the Circuit Court of Appeals for the Second Circuit in *National Outdoor Advertising Bureau v. Helvering*, 89 F. (2d) 878, in which it was held that the taxpayer could not deduct as a necessary business expense the sum spent in negotiating a consent decree in a suit in equity brought by the United States under the anti-trust laws.

The decision of the court below is also basically in conflict with *Helvering v. Superior Wines and Liquors, Inc.* (C. C. A. 8), decided March 22, 1943 (1943 C. C. H., Par. 9354), which denied a deduction for the sum paid as a compromise of a liquor law violation and also the sum paid for the attorneys' fees in connection with the settlement.

The above decisions of the Second and Eighth Circuits are consistent with and are supported by numerous cases. They accordingly indicate the

policy which has been followed by courts in similar circumstances. See *Textile Mills Corp. v. Commissioner*, 314 U. S. 326, upholding regulations interpreting ordinary and necessary business expenses as not including lobbying expense to procure legislation; *United States v. Jaffray*, 97 F. (2d) 488 (C. C. A. 8),² denying the deduction of a sum paid as a penalty for a negligent understatement of taxes; *Great Northern Ry. Co. v. Commissioner*, 40 F. (2d) 372 (C. C. A. 8), certiorari denied, 282 U. S. 855, denying a deduction of a penalty paid for violation of a statute pertaining to railroads; *Burroughs Bldg. Material Co. v. Commissioner*, 47 F. (2d) 178 (C. C. A. 2), denying the deduction of counsel fees as well as fines paid in the prosecution of violators of a price-fixing statute; *McDuffie v. United States*, 19 F. Supp. 239 (C. Cls.), denying deduction of sums spent in unsuccessfully defending a suit brought by the United States for cancellation of a lease on grounds of fraud; and *Maddas v. Commissioner*, 40 B. T. A. 572, affirmed, 114 F. (2d) 548 (C. C. A. 3), refusing to allow deduction of sums paid for protection in running an illegal business. In earlier cases the Seventh Circuit itself took a view in accord with these decisions. See *Tinkoff v. Commissioner*, 120 F. (2d) 564, and *Standard Oil Co. v. Commissioner*, 129 F. (2d) 363, certiorari

² Affirmed on other issues *sub nom. United States v. Bertlesen & Petersen Co.*, 306 U. S. 276.

denied, 317 U. S. 688. Consequently, its decision in the instant case is contrary to a well established current of decision and produces uncertainty as to whether expenditures in connection with illegal activities may be deducted as "ordinary and necessary" expenses. The problem is recurrent and warrants consideration by this Court in view of the conflict.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.

MAY 1943.

APPENDIX

Revenue Act of 1936, c. 690, 49 Stat. 1648:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

(a) *Expenses*.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including a reasonable allowance for salaries or other compensation for personal services actually rendered; traveling expenses (including the entire amount expended for meals and lodging) while away from home in the pursuit of a trade or business; and rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

Revenue Act of 1938, c. 289, 52 Stat. 447:

Section 23 (a) is identical with Section 23 (a) of the Revenue Act of 1936, *supra*.

Revised Statutes:

SEC. 3929. The Postmaster General may, upon evidence satisfactory to him that any person or company is engaged in conducting any lottery, ~~gift~~ enterprise, or scheme for the distribution of money, or of any real or personal property by lot, chance, or drawing of any kind, or that any person or company is conducting any other scheme

or device for obtaining money or property of any kind through the mails by means of false or fraudulent pretenses, representations, or promises, instruct postmasters at any post office at which registered letters or any other letters or mail matter arrive directed to any such person or company, or to the agent or representative of any such person * * * to return all such mail matter to the postmaster at the office at which it was originally mailed, with the word "Fraudulent" plainly written or stamped upon the outside thereof; and all such mail matter so returned to such postmasters shall be by them returned to the writers thereof, under such regulations as the Postmaster General may prescribe. Nothing contained in this section shall be so construed as to authorize any postmaster or other person to open any letter not addressed to himself. * * * (39 U. S. C., sec. 259.)

Treasury Regulations 94, promulgated under the Revenue Act of 1936:

ART. 23 (a)-1. *Business expenses.*—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, * * *. Among the items included in business expenses are management expenses, commissions, labor, supplies, incidental repairs, operating expenses of automobiles used in the trade or business, traveling expenses while away from home solely in the pursuit of a trade or business (see article 23 (a)-2), advertising and other selling expenses, together with insurance premiums against fire, storm, theft, acci-

dent, or other similar losses in the case of a business, and rental for the use of business property. Penalty payments with respect to Federal taxes, whether on account of negligence, delinquency, or fraud, are not deductible from gross income. The full amount of the allowable deduction for ordinary and necessary expenses in carrying on a business is nevertheless deductible, even though such expenses exceed the gross income derived during the taxable year from such business. As to items not deductible under any provisions of section 23, see section 24.

Treasury Regulations 101, promulgated under the Revenue Act of 1938:

Article 23 (a)-1 is identical with Article 23 (a)-1 of Treasury Regulations 94, *supra*.